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SUBJECT: REAL ESTATE MARKET DOWNTURN RAISES UNEMPLOYMENT
CONCERNS

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¶1. (SBU) Summary. As commonly predicted, housing sales and construction in Spain have steadily decreased this year, with sales of new and used homes down by almost 20 percent since the first quarter of 2007. Real estate developers are taking the brunt of this downturn, while other players have hedged their bets by diversifying and investing abroad. Meanwhile, nearly all Spanish homeowners continue to pay their mortgages on time, although higher interest rates and inflation are making dents to their pocketbooks. Most economic analysts continue to support a soft-landing theory, but the unemployment effect (with estimates of lost construction jobs reaching 300,000 for 2008) will be a key variable to watch. End Summary.

END OF BOOM: HOME SALES DOWN

¶2. (SBU) Following a 10-year boom, Spain's residential real-estate market is finally experiencing the slowdown long-predicted by so many experts. Decreasing levels of demand coupled with oversupply and tighter credit have finally taken their toll. Statistics compiled by the College of Property Registrars show that sales of both new and used homes decreased steadily in 2007 with 232,358 registered sales in the first quarter and only 188,256 in the third quarter. Representatives of the G-14 industry association, which represents 14 of the biggest real estate companies in Spain, told reporters December 16 that housing starts since August were down 40 percent compared with the same period a year earlier. Furthermore, there are indications that home prices are also starting to decline based on data from a recent local survey showing that used home prices in Madrid and Barcelona were down by 0.3 percent and 2 percent, respectively.

DEVELOPERS IN TROUBLE, WHILE OTHERS HAVE DIVERSIFIED

¶3. (SBU) Real estate developers are feeling the brunt of this downward turn and have booked sharp declines in profits. High profile collapses such as Valencia real estate developer Llanera (forced into receivership), Barcelona property firm Habitat (fell behind in payments to creditors), and Basque property developer Ereaga (declared insolvency) are beginning to make the news. Analysts are also concerned about the resilience of hundreds of smaller developers that cropped up during the boom.

¶4. (SBU) On the other hand, developers that expanded abroad

are surviving and are continuing their investments in Eastern Europe, North Africa, and Latin and North America. According to Bank of Spain data, Spanish home buyers are following this example by investing more than 5.5 billion euros in first or second homes abroad so far in 2007, a significant increase from 3.4 billion in 2006.

15. (SBU) Construction firms appear less exposed to the slowing housing construction market, in part because government-supported infrastructure projects comprise a large portion of Spain's construction activity. Additionally, commercial property sales have generally not followed the same downward trend as residential real estate since demand for office space remains high. The share prices of real estate firms are taking a beating, construction companies much less so.

16. (SBU) Prominent Spanish construction firms such as Ferrovial, ACS FCC, Acciona, OHL, and Sacyr Vallehermoso have also minimized their exposure by developing stable, growing overseas operations. FCC has become the second largest industrial waste player in the United States, while Acciona has become the world's third largest wind-power. OHL recently won five water purification and delivery contracts in the Czech Republic while Sacyr Vallehermoso announced recently that it would be partnering with the Libyan Company for Development and Investment to work on large-scale infrastructure projects in Libya.

HOMEOWNERS OK - FOR NOW

17. (SBU) Meanwhile, Spanish homeowners continue to pay their mortgages, although overall nonpayment of all types of loans is inching upwards. Default levels remain low by European standards at 0.82%. With monthly mortgage payments averaging

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half of take home pay, increased inflation and interest rates will likely cause strain to borrowers. Since the majority of Spanish mortgages are variable rate mortgages tied to the Euribor (which has risen significantly over the last year) borrowers are being forced to spend more on mortgage payments than they did a year ago. Despite these pressures, the common consensus is that most homeowners will continue to be able to make their payments, buffered by savings or other adjustments.

18. (SBU) Future unemployment may be the figurative straw that breaks the camel's back for some homeowners, as up to 20 percent of Spain's workforce is tied in some way to the construction economy according to Ministry of Labor data. Minister of Housing Carme Chacon recently noted that the level of newly constructed homes in 2008 would decrease by 250,000, an amount which real-estate company Martinasa President Fernando Martin optimistically estimated would erase "only" 300,000 construction jobs. Martin, bankers, and GOS officials have argued that the economy will be able to absorb many of these laid-off workers since net employment is still rising, albeit more slowly. However, it is not clear how many of those laid off will be able to find new jobs if the overall economic climate deteriorates.

COMMENT

19. (SBU) While GOS officials downplay the effects of the housing market downturn, others are not as optimistic. The timing of this slump in particular is uncomfortable for this government as it heads into an election. In addition to a slowing economy, the threat of employment loss looms on the horizon. Whether developers will be able to meet their

substantial debt obligations is also an important question. Some experts estimate that 60 percent of Spain's financial sector (banks and savings banks) go to real estate lending, a significant portion of which goes to developers. Despite these concerns, most local experts continue to predict a soft landing.

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